UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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ERICK J. FEITSHANS, an individual;
STEVE HODGES, an individual,

06 CIV. 2125 (SAS)

Plaintiffs,

vs.

MICHAEL KAHN, an individual;
LAURA KAHN, an individual;
MICHAEL ASHKIN, an individual;
WINTER FILMS, LLC, a New York Limited Liability Company; IKAHN PRODUCTIONS, INC., a New York Corporation; AND DOES 1-10 inclusively,

Defendants.

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MEMORANDUM OF LAW IN FURTHER SUPPORT OF
DEFENDANTS' MOTION TO DISMISS THE COMPLAINT

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Defendants submit this Memorandum of Law, in further support of their Motion to Dismiss Plaintiffs' Complaint, and in reply to Plaintiffs' opposition to Defendants' Motion to Dismiss Plaintiffs' Complaint.

PRELIMINARY STATEMENT

Plaintiffs' Complaint should be dismissed on the grounds of res judicata and collateral estoppel since it seeks to relitigate issues and claims already raised and adjudicated. Plaintiffs arbitrated the breach of contract claims against the Entity Defendants. Now they seek to relitigate those same claims against the Alter Ego Defendants who are parties in privity with the Entity Defendants. Plaintiffs are seeking to relitigate their breach of contract claims on the theory of alter ego liability. Like their breach of contract claims, the issue of alter ego liability was raised when the Kahns were named in the Plaintiffs' Demand for Arbitration and adjudicated in the Order Staying Arbitration. For these reasons, the Complaint must be dismissed in it entirety.

STATEMENT OF FACTS

Defendants respectfully refer the Court to their Memorandum of Law dated May 30, 2006 ("Defendants' Memo.")[1] for a full recitation of the Statement of Facts. (Defendants' Memo., pp. 2-6).

ARGUMENT

I. THE MOTION TO DISMISS AND ANSWER WERE PROPERLY FILED TOGETHER

The motion and answer were ordered to be filed and served simultaneously by the Court at the scheduling conference held before the Honorable Shira A. Scheindlin on or about May 15, 2006. Thus, Defendants did not violate any federal rules of civil procedure.

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[1] The abbreviations used herein are the same as those set forth in Defendants' Memo.

II. PRIVITY OF PARTIES AND ALTER EGO LIABILITY ARE NOT ONE IN THE SAME AND PRIVITY CANNOT COMPEL A NON-SIGNATORY TO ARBITRATE

a. Plaintiffs confuse the concept of privity and the theory of alter ego.

In their opposition, Plaintiffs describe the concept of privity and the theory of alter ego as one in the same. Since the Alter Ego Defendants and the Entity Defendants are parties in privity for purposes of asserting the doctrines of res judicata and collateral estoppel, Plaintiffs argue that it automatically follows that the Alter Ego Defendants are bound by and liable for the New York Judgment. Plaintiffs are just plain wrong.

Plaintiffs inaccurately rely upon *Ammcon v. Kemp*, 826 F. Supp. 639 (E.D.N.Y. 1993) and *Omaha Indemnity v. Royal American Managers*, 755 F. Supp. 1451 (W.D.Mo. 1991) to support their proposition that "it is the general rule the privies/alter egos are liable for the judgment entered against the Defendants." (Plaintiffs' Memorandum of Points and Authorities In Opposition to Defendants' Motion to Dismiss the Complaint dated June 20, 2006 ("Plaintiffs' Memo."), p. 6). In *Ammcon*, the Department of Housing and Urban Development ("HUD") is described as the alter ego of First Baptist Church of Crown Heights Senior Citizens Housing Development Fund Corporation ("First Baptist"). An arbitration and subsequent federal action were brought by the plaintiff general contractor seeking payment for the development project. Though First Baptist is named in the arbitration and an award entered against it, HUD was integrally involved with the project. HUD was not present and not notified of the Article 75 proceeding confirming the arbitration award against First Baptist. Thus, HUD refused to pay the award and the federal action was commenced by the general contractor. There is no discussion in *Ammcon* about how the court arrived at its determination that HUD was the alter ego of First Baptist. It can only be assumed from the facts that HUD exhibited enough "dominion and control" over First Baptist to be considered an alter ego.[2] More importantly, nowhere in *Ammcon* does the court find that simply because HUD was in privity with [First Baptist], it was, as a matter of law, its alter ego.

Plaintiffs selectively reveal the circumstances found in *Omaha Indemnity.* (Plaintiffs' Memo., p. 7). In the case of *Omaha Indemnity*, certain officers and shareholders were found to have committed "tortious corporate conduct" and dominated and controlled the corporate entity to commit an injustice or fraud. *Omaha Indemnity*, 755 F. Supp. at 1458. The individual officers and shareholders at issue were found to be the alter egos of the corporation. It was their positions as officers and shareholders that created the privity with the corporation. However, it was the abuse of the corporate entity by the certain officers and shareholders that bound them to or made them liable for the judgment in the case.

Contrary to Plaintiffs' unsupported assertions, parties in privity are not, as a matter of law, liable for the obligations of each other. A finding of privity does not prove alter ego theory. *See,* fn. 2. The only way to hold an individual liable for the debts of the corporation, even if the individual is an officer, is under a theory of alter ego. *See,* fn. 2.

Plaintiffs believe that privity and alter ego are one in the same. On the other hand, they correctly identify that "there is some considerable difference between being the alter ego of a corporation and being an officer of that corporation." (Plaintiffs' Memo., p. 10). Being an officer of a corporation automatically places the individual and the entity in *privity*.[3] While *alter ego* requires a showing that an individual exercised "dominion and control over a corporation" and "this control was used to 'commit fraud or wrong'" *See*, fn.2.[4]

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[2] "To establish alter ego liability it is necessary to show that the individual defendant exercised such complete dominion and control that the corporation lacked independent will and that this control was used to 'commit fraud or wrong' against the plaintiff." *Manos v. Geissler*, 377 F. Supp. 2d 422, 425 (S.D.N.Y. 2005) (citing *Barbezat v. Arnell Group, Ltd.*, 96 Civ. 9790, 1997 U.S. LEXIS 12253, at *1 (S.D.N.Y. Aug. 19, 1997).

Plaintiffs' confusion regarding privity and alter ego aside, they acknowledge the fact that the Alter Ego Defendants are parties in privity with the Entity Defendants. (Plaintiffs' Memo., p. 9). As for alter ego, Defendants assert that Plaintiffs raised the issue and it was adjudicated. (discussed, *infra*.) Thus, Plaintiffs' Complaint is rendered moot and should be dismissed pursuant to the doctrines of res judicata and collateral estoppel.

b. Privity is not a ground to compel arbitration from a non-signatory.

Privity, by itself, is not a ground by which to compel arbitration from a non-signatory to an arbitration agreement.[5] Plaintiffs claim that "a line of cases hold that a non-signatory privy can be forced to arbitrate. (Plaintiffs' Memo., fn. 1, p.9). They cite to *no* cases.

However, later in their opposition papers, Plaintiffs cite to *Local Union No. 38 v. Custom Air Systems, Inc.*, 357 F.3d 266, 268 (2d Cir. 2004). The issue before the Second Circuit in *Local Union* was whether an arbitration award can be confirmed against a non-signatory absent a threshold finding that the non-signatory was the alter ego of the party to the arbitration agreement. The non-signatory was served with an arbitration demand and never objected. The Second Circuit found that since the district court never made a determination regarding the issue of alter ego, the non-signatory could not be bound by the award and could not be time-barred from challenging the confirmation of the award.

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[3] It is unclear why Plaintiffs accuse Defendants of keeping secret the fact that the Kahns, as officers of the Entity Defendants, are parties in privity with the Entity Defendants. (Plaintiffs' Memo., pp. 7-8). M. Kahn signed the Employment Agreements as the CEO and President of the respective Entity Defendants in November 1999 and March 2000. (Romeo Aff., Exhs. B and C).

[4] See Point III, *infra*.

[5] It is well settled that the Second Circuit recognizes the following five theories to compel arbitration from nonsignatories to arbitration agreements: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel. *See Am. Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130, 133 (2d Cir. 1997); *Thomson-CSF, S.A. v. Am. Arbitration Assoc.*, 64 F.3d 773, 776 (2d Cir. 1995); *see also EGL Gem Lab Ltd. v. Gem Quality Inst.*, No. 97 Civ. 7102, 1998 WL 314767, at *2 (S.D.N.Y. June 15, 1998). Alter ego was the only plausible theory Plaintiffs could have used to compel the Kahns, as non-signatories, to arbitrate.

Here, the Kahns, non-signatories to the arbitration agreement, were served with the Demand for Arbitration and promptly moved for a stay. The demand and the move for the stay raised the issue of alter ego, one of five theories to compel a non-signatory to arbitrate. *See, Thomson-CSF, S.A. v. Am. Arbitration Assoc.*, 64 F.3d 773, 776 (2d Cir. 1995). The Plaintiffs chose not to oppose the application. The Order Staying Arbitration was granted as to the Kahns. Thus, unlike the *Local Union No. 38* case, the issue of alter ego was considered and adjudicated by the New York State Supreme Court.

Plaintiffs also argue that compelling the Kahns to arbitrate on a theory of alter ego is "plain nonsense." (Plaintiffs' Memo., p. 2). Plaintiffs insist that their actual reason for compelling the Kahns to arbitrate as non-signatories "were as officers of the Entity Defendants named and their knowingly tortuous [sic] conduct [by an officer of a corporation]." (Plaintiffs' Memo., p. 2). And the reason the Kahns were named as parties was "solely because they were officers of the Entity Defendants, not as alter egos of the Entity Defendants. (Plaintiffs' Memo., p. 10). Regardless of how Plaintiffs would like to contort their reasoning, it sounds in alter ego liability.

III. THE ISSUE OF ALTER EGO WAS ADJUCICATED, PLAINTIFFS WERE GIVEN AN OPPORTUNITY TO LITIGATE THE ISSUE AND SHOULD BE COLLATERALLY ESTOPPED FROM ASSERTING OTHERWISE

Plaintiffs insist the issue of alter ego liability was "never raised, discussed, argued or adjudicated in any prior proceeding." (Plaintiffs' Memo., p. 6). They make this statement despite acknowledging that they included the Kahns in Plaintiffs' Demand for Arbitration and claiming the "actual reason" for compelling the Kahns to arbitrate as non-signatories "were officers of the Entity Defendants named and their knowingly tortuous [sic] conduct [by an officer of a corporation." (Plaintiffs' Memo., p. 2).

Plaintiffs' further argue that they were never given the opportunity to fully litigate the issue of alter ego. They claim the Order to Show Cause hearing was held without adequate notice. Again, not only are Plaintiffs wrong, but here they misrepresent the facts to the Court.

Plaintiffs were initially served with Notice of Petition to Stay Arbitration on November 21, 2002. (Romeo Aff., Exh. E). The notice was replaced by an Order to Show Cause to Stay Arbitration and served on Plaintiff Feitshans on December 3, 2002 and on Plaintiff Hodges on December 4, 2002. (Romeo Aff., Exh. E). The show cause hearing was initially scheduled for December 6, 2002 and was subsequently adjourned ***at the request of Plaintiff Feitshans***, a California attorney, to January 3, 2003. Plaintiffs were advised of that date. (See Letter dated December 6, 2002 annexed to Reply Affirmation of Richard P. Romeo ("Reply Romeo Aff.") dated June 30, 2006 as Exhibit ("Exh.") 1). On January 3, 2003 the show cause hearing was held before the Honorable Ronald Zweibel. (See transcript of Order to Show Cause hearing dated January 3, 2003 annexed to Reply Romeo Aff. as Exh. 2).[6] Despite requesting an adjournment, Plaintiffs did not appear on January 3, 2003. Subsequent to the hearing, Plaintiffs were served with a Notice of Settlement on or about January 6, 2003 to settle the Order Staying Arbitration. (See Notice of Settlement dated January 6, 2003 annexed to Reply Romeo Aff. as

[6] The transcript of the Order to Show Cause hearing shows that Plaintiff Feitshans had contact with the court ***almost one (1) month*** before the hearing. It also demonstrates to what lengths the Defendants, at the direction of the court, went to in notifying Plaintiffs of the hearing.

Exh. 3). Plaintiffs also were served with Notice of Entry of the Order Staying Arbitration. (See Romeo Aff., Exh. G). Plaintiffs never filed a counter order or moved to vacate the default.

Plaintiffs had both notice and opportunity to litigate the alter ego issue. Further, Plaintiffs boldly admit they did not oppose the proceedings to stay arbitration as against the Kahns. (Plaintiffs' Memo., p. 10). They rationalize the decision not to appear in the New York State Supreme action as follows: "In the case of a default judgment, for example, a party may decide that the amount at stake does not justify the expense and vexation of putting up a fight. The defaulting party will lose that lawsuit, but the default is not given collateral estoppel or res judicata effect." *Spilman v. Harley*, 656 F.2d 224 (6th Cir. 1981); *Commonwealth of Massachusetts v. Hale*, 618 F.2d 143 (1st Cir. 1980); *Matter of McMillan*, 579 F.2d 289 (3d Cir. 1978); *see also*, Plaintiffs' Memo., pp. 10-11.

Plaintiffs purposefully did not appear at the Order to Show Cause hearing believing a default judgment would not have a preclusive effect on later claims against the Alter Ego Defendants. Yet again, Plaintiffs are wrong. This district has found that "[a] judgment on the merits for purposes of res judicata is not necessarily a judgment based upon a trial of contested facts; it may, for example, be a default judgment." *Amadasu v. Bronx Lebanon Hospital Ctr.*, 03 Civ. 6450, 2005 WL 121746 at *6 (S.D.N.Y. Jan. 10, 2005)[7] (citing *Dillard v. Henderson,* 43 F. Supp. 2d. 367, 369).

The cases cited by Plaintiffs do not support Plaintiffs' argument that default judgments cannot be given res judicata or collateral estoppel effect. In *Spilman, Commonwealth of Massachusetts and In re McMillan*, the courts refused to give res judicata/collateral estoppel effect to actions to discharge a debt under federal bankruptcy law based on the underlying state law judgment. These rulings did not focus on the fact that the underlying judgment was a default judgment. Rather, the courts in *Spilman, Commonwealth of Massachusetts, and In re McMillan* all refused to apply res judicata because although the elements of the underlying state law claims were satisfied, the courts noted that proof of the elements of those claims did not necessarily mean that the parties had proved the elements necessary to establish dischargeability under bankruptcy law. In short, the issues presented in the above bankruptcy cases were different from the issues presented in the underlying state court causes of action and for that reason, the courts refused to apply the doctrines of res judicata and collateral estoppel.

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[7] Please note this case was incorrectly entitled in Defendants' Memo. as *Adamasu v. Bronx Lebanon Hospital Ctr.*

If Plaintiffs had appeared at the show cause hearing in January 2003, they could have requested the discovery that they claim prevented them from opposing the Order to Show Cause. (Plaintiffs' Memo., pp. 10, 16). After the Order Staying Arbitration was granted and Plaintiffs were served with both Notice of Settlement and Notice of Entry, Plaintiffs could have moved to have the Order Staying Arbitration vacated. (Plaintiffs had one (1) year from the date of Notice of Entry, February 21, 2003 to vacate under CPLR § 3015) (Romeo Aff., Exh. G). Plaintiffs did neither. They sat on their rights.[8] Now Plaintiffs want this Court to reward their apathy towards the stay proceedings and give them a second "opportunity" to litigate the alter ego issue.

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[8] In *Ammcon v. Kemp*, discussed *supra*, the court finds that although HUD was not a party to the arbitration, it should have moved to vacate or modify the arbitration award under [CPLR] § 7511. HUD chose not to do so. The court then said it could not "sanction HUD's glaring attempt to circumvent New York's statutory scheme relating to arbitration awards by allowing it to relitigate [plaintiff's] arbitration award in this proceeding." 826 F. Supp. 639, 646. Here, in further support of Plaintiffs' argument that they were denied an opportunity for a full and fair hearing, they cite to two New York Appellate Court, Second Department cases, *Hon Kuen Lo v. Gong Park Realty Corp.*, 16 A.D.3d 553 (2d Dept. 2005) and *Ford v. 536 E. 5th St. Equities*, 304 A.D. 2d 615 (2d Dept. 2003). Both cases involve parties seeking to vacate orders of the court and they were granted. Plaintiffs, here, had the option to confirm, vacate or modify the Arbitration Award and Plaintiffs chose to confirm the Award. Plaintiffs, here, had the option to

There is no doubt the issue of alter ego was previously raised by Plaintiffs themselves in their Demand for Arbitration and also in Defendants' Order to Show Cause. However, Plaintiffs' made a conscious choice avoiding, in their own words, "the expense and vexation of putting up a fight" by not appearing and waiving their opportunity to contest the alter ego issue. The issue was litigated before the New York State Supreme Court. Thus, Plaintiffs are collaterally estopped from relitigating the issue of alter ego liability.

IV. PLAINTIFFS ACKNOWLEDGE THEIR BREACH OF CONTRACT CLAIMS ARE BARRED BY RES JUDICATA

According to the Complaint, Plaintiffs seek to relitigate their breach of contract claims against the Kahns, Ashkin and Darby after they received and confirmed the Arbitration Award against the Entity Defendants for the exact same claims. This motion seeks to dismiss the breach of contract claims because they are barred pursuant to the doctrine of res judicata. After reviewing Plaintiffs' opposition papers, they apparently agree.

Plaintiffs' admit that "there was a final judgment as to the claims alleged by plaintiffs in the arbitration." (Plaintiffs' Memo., p. 13). "That judgment was entered by the New York Supreme Court, certainly a court of competent jurisdiction." (Plaintiffs' Memo., p. 13). Although the parties are not the same, the Alter Ego Defendants are parties in privity with the Entity Defendants.[9] Finally, Plaintiffs acknowledge that the claims are the same. That is, the

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vacate the default granted in the Order Staying Arbitration and did not. This Court, like the court in *Ammcon*, should not allow Plaintiffs to "circumvent New York's statutory scheme" relating to arbitration awards and defaults by allowing them to relitigate their Arbitration Award.

[9] A fact not denied by Plaintiffs. (Plaintiffs' Memo., p.9). Moreover, Plaintiffs imply that the Entity Defendants are parties protected by the doctrines of res judicata and collateral estoppel. ("The question is whether the Alter Ego Defendants as privies are entitled to the protections of the Entity Defendants pursuant to the doctrines of res judicata and collateral estoppel.") (Plaintiffs' Memo., p. 13).

breach of contract claims were brought and determined through arbitration and they are the only claims in Plaintiffs' Complaint.[10] (Plaintiffs' Memo., pp. 13-14).

Therefore, Plaintiffs' breach of contract claims should not be relitigated pursuant to the doctrine of res judicata and Plaintiffs' Complaint dismissed in its entirety.

CONCLUSION

For all of the foregoing reasons, Defendants respectfully request the Court dismiss Plaintiffs' Second Amended Complaint, with prejudice, together with such other and further relief as the Court deems just and proper.

Dated: New York, New York
June 30, 2006

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[10] Plaintiffs incorrectly describe alter ego liability as a colorable claim. There is no cause of action for alter ego. Rather, alter ego is a theory of liability through which a claim like breach of contract can be asserted against a party.